

A medical appliance is defined as an item that is intended by its manufacturer for use in directly substituting for a malfunctioning part of the body. See 86 Ill. Adm. Code 130.310(c). (This is a GIL).

September 29, 1999

Dear Ms. Xxxxx:

This letter is in response to your letter dated August 12, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

I am a Board Certified Ocularist and I am seeking legal advice regarding medical sales tax. In July 1999 I incorporated my business which is the fitting and fabrication of custom ocular prostheses. I have been having a very difficult time getting clear answers from the Sales Tax Office at the State of Illinois Building in Chicago. I have been there in person several times in the past three months and noone is able to help. The supervisor has been trying to guide me but has been unable to advise me on this issue and recommended that I contact you directly.

What is so difficult about my business is that we do not separate our charge for an eye into a service portion and a Durable Medical portion. If I were to do that, which is difficult to estimate, the actual cost of the artificial eye itself would be less than 5% of my bill.

When I incorporated and registered with the State of Illinois to do business, I personally went down to the State of Illinois office and filled out all the necessary paperwork. The employee who input my information put me on a monthly pay schedule and I received my first ST-1 form. In attempt to fill it out properly, I have sought the help of PERSON, my CPA and my attorney, none of whom could give me an answer. PERSON suggested that since I am in such a unique, niche profession, I should ask you for a ruling. **He also believes that since every eye is custom made, I may be exempt from the medical sales tax.**

I believe it will help you to better understand what I do if I describe the procedures involved in making an eye. I will also describe the various services I provide in my practice.

As an Ocularist, I fit and fabricate custom ocular prostheses for patients who have lost an eye. These prostheses are all custom made from a impression taken of the patient's socket. This impression is then cast in wax which I use as a pattern. I try the wax shape into their socket many times and evaluate the lid contours then sculpt the shape as necessary. I then determine the artificial eye's direction of gaze and indicate that on the wax pattern. Once I complete the shape, I paint their iris with oil paints, matching their companion eye (if they have one). This will eventually be incorporated into the final product. I then make a two-piece stone mold of the wax pattern, remove the wax, key in the iris button, add acrylic and cure it. The patient returns another time for final artwork and the prosthesis is cured again. The patient then receives the final product. In addition, I fit and fabricate scleral shell prostheses which cover a phthisical, non-seeing eye. The procedure is similar to that of an artificial eye.

In addition, I am having a difficult time determining how to figure out the tax on Medicare patients' prostheses. I know that Medicare and Medicaid payments are exempt from this medical tax. However, since I generally do not accept assignment for Medicare, the patient receives the payment. The patient then writes a check to my corporation in the amount of the Medicare payment in addition to the remainder of their bill (which is not exempt from the tax). These payments come in at various times sometimes months apart and I am not sure how to determine when and where to subtract out the exempt portion. I will owe approximately \$1.90 in medical tax this month.

I would be very grateful for a ruling to determine whether or not it is necessary for me to file for this negligible medical tax on custom made artificial eyes and if it is mandatory, then please advise me as to how to calculate the tax due.

Your immediate attention will be greatly appreciated.

Medicines and medical appliances are not taxed at the normal rate of 6.25%. These items are taxed at a lower rate of 1%. See the enclosed copy of 86 Ill. Adm. Code 130.310. Items subject to this lower tax rate include prescription and nonprescription medicines, drugs, medical appliances, and insulin, urine testing utensils, syringes, and needles used by diabetics, for human use.

A medical appliance is defined as an item that is intended by its manufacturer for use in directly substituting for a malfunctioning part of the body. See part (c) of Section 130.310. Medical devices that are used for diagnostic or treatment purposes do not qualify for the lower tax rate.

In general, in order to qualify as a medical appliance, the product must directly substitute for a malfunctioning part of the body. "Prosthetic device" is not defined in the regulations. As described in Section 130.310, medical

appliances qualify for the lower tax rate. A medical appliance is defined as an item that is intended by its manufacturer for use in directly substituting for a malfunctioning part of the body. See part (c) of Section 130.310. Given that the generally recognized meaning of "prosthetic device" is the artificial replacement of a part of the body, most prosthetic devices would fall within the definition of "medical appliances." Artificial eyes, such as described in your letter, do qualify as a medical appliance subject to the low rate of tax.

Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

In your letter you state that you are a de minimis serviceman. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f) enclosed. Methods 3 and 4, above, apply to de minimis servicemen. The third method by which servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business (e.g., they make some type of over-the-counter sales to persons). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers.

The fourth method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their

suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

Please be advised, sales made to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active exemption identification number. See 86 Ill. Adm. Code 130.2080(a). This rule applies to all servicemen except for unregistered de minimis servicemen who apply method 4 set forth above. While no tax may be due on payments made directly to vendors by Medicare or Medicaid, tax is due upon any portions of bills paid by individuals or private insurance companies not covered by Medicare and Medicaid. This means when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. Please note that the Department is currently reviewing the application of this rule and it may be changed within the next six months.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.